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# Towards a Global Carbon Integrity System: Learning from the GFC<sup>1</sup> and Avoiding a GCC<sup>2</sup>

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## ABSTRACT

*This paper examines some of the central global ethical and governance challenges of climate change and carbon emissions reduction in relation to globalization, the “global financial crisis” (GFC), and unsustainable conceptions of the “good life”, and argues in favour of the development of a global carbon “integrity system”. It is argued that a fundamental driver of our climate problems is the incipient spread of an unsustainable Western version of the “good life”, where resource-intensive, high-carbon western lifestyles, although frequently criticized as unsustainable and deeply unsatisfying, appear to have established an unearned ethical legitimacy. While the ultimate solution to climate change is the development of low carbon lifestyles, the paper argues that it is also important that economic incentives support and stimulate that search: the sustainable versions of the good life provide an ethical pull, whilst the incentives provide an economic push. Yet, if we are going to secure sustainable low carbon lifestyles, it is argued, we need more than the ethical pull and the economic push. Each needs to be institutionalized—built into the governance of global, regional, national, sub-regional, corporate and professional institutions. Where currently weakness in each exacerbates the weaknesses in others, it is argued that governance reform is required in all areas supporting sustainable, low carbon versions of the good life.*

**Keywords:** Integrity System, Climate Change, Carbon, Good Life, Ethics, Governance

## 1. Introduction

It is just over a decade since I was first invited to think about the ethical and governance problems surrounding the issues of global warming—giving the opening keynote to a world council colloquium on carbon trading. The commonly perceived ethical issue at the time was that carbon trading would allow developed countries to avoid their responsibility for fixing the problem they had caused. My views on carbon trading were informed by recognizing:

1) The value of well governed markets and the effectiveness of clear price signals. Putting a price on carbon could have dramatic effects on the decisions of consumers, investors and providers of goods and services. However, through direct experience of currency markets during the 1980s, I recognized that market players could profit from generating volatility in which they profited at

the expense of those investing in the provision of goods and services.<sup>3</sup>

2) That markets involve the trading of property rights and the “initial distribution” of those property rights was irrelevant in some theories of market operation but vitally important as a matter of ethics and justice.

3) Economic incentives are an important governance tool but, like all governance tools, they are most effective as part of a package of ethical standard setting, legal regulation and institutional reform and such packages are necessary for major reforms to succeed (Sampford, 1990, 1992). The primary ethical question is not about how the economic incentives are activated but the overall value of major reforms they seek to secure.

The conclusions I drew were that:

1) The fundamental problem was that an unsustainable

<sup>1</sup>The “GFC” in popular Australian parlance refers to the “global financial crisis” which began in 2008.

<sup>2</sup>A “Global Carbon Crisis” to parallel the GFC.

<sup>3</sup>In promoting volatility, traders benefited at the expense of those who needed to exchange currencies to conduct business through a combination of asymmetric knowledge and outright manipulation. Although some risks could be hedged (generating major profits for the market players), long term risk was uninsurable. By increasing the risk of doing business, it discouraged what would be otherwise profitable investment.

“high carbon” version of the “good life” had been developed in the west and was increasingly sought by the rest.

2) The wealthiest countries were pressing for carbon trading schemes because all such schemes allocated more *per capita* rights to emit to themselves than to others. This proposal effectively created property rights in unsustainable activities (emitting carbon) and allocated most of those to the countries which had already contributed most to the problem. The outcome of which was neither fair nor likely to be agreed by the less developed countries.

3) The wealthiest countries wanted to buy some of these limited rights from less developed countries. However, if the latter still sought high carbon lifestyles the extra resources would be expended on high carbon activities.

4) Accordingly, low carbon versions of the good life that both the west and the rest wanted to live were essential to solving global warming. This could be assisted by putting a price on carbon (preferably through carbon taxes).

5) Grandfathered trading schemes encouraged investment in unsustainable activities.

6) Part of the “good life” involved meaningful and rewarding work and we should look to stimulate low carbon or no carbon industries that would provide such work. Carbon taxes would help promote low carbon industries.

In the intervening decade, I have not returned to this theme in the same holistic way although some elements have been included in other papers and publications and new arguments made about the advantages of a “carbon added tax” and similarities between the problems of water trading and carbon trading [1,2]. However, I have continued to suggest that the centrality of conceptions of the good life to addressing climate change within the United Nations University and Griffith University. As a result, the World Institute for Development Economics Research (UNU-WIDER) initiated discussions on the theme and the Griffith Institute for Social and Behavioural Research (GISBR) chose this theme for its launch conference. My paper was later published as the lead essay in a special edition of the *Australian Journal of Social Issues* [3]. In setting out these ideas and their interaction with globalization and the global financial crisis (GFC), the discussion of each will necessarily be brief.

## 2. Globalization and Governance

Over the last twenty years, the flow of money, goods, people and ideas across borders has threatened to overwhelm the system of sovereign states. Much activity has moved outside the control of nation states at the same time as nation states have “deregulated” and “privatized”.<sup>4</sup> Such policies have transferred power from those

exercising governmental power at the nominal behest of the majority of its citizens to those with greater wealth or greater knowledge in markets in which knowledge is typically asymmetric and in which power is distributed on a very different basis of one dollar one value rather than one vote one value.

It is now recognised that many governance problems have arisen because of globalization and can only be addressed by global solutions [4]. It must also be recognized that governance problems at the national level contribute to governance problems and the global level and *vice versa*. This is true of current issues from the melting Greenland glaciers to the ethical and financial meltdown of Wall Street. In both cases, there are glaring and mutually reinforcing weaknesses in global governance institutions, national governance institutions, and corporations. In the case of the financial crisis, there have been significant failures of professions and those whose advice is trusted. From the ratings agencies, to corporations, to superannuation funds, to banks, to governments and multilateral agencies, institutions must be redesigned to increase the probability that they will use the power entrusted in them to serve the public interest in the way they claim. With climate change there have been serial and mutually reinforcing failures in global governance (as seen in Copenhagen), national governance (with failures to agree on the extent of the problem and the means for addressing it) and corporate governance (from short termism to green-wash). However, if we are going to demand that institutions are to serve our interests and values, it is critical that we are clear to ourselves what our values are and how those values are integrated into our view of the good life and that of our actions as citizens, consumers and investors.

## 3. Carbon, Climate Change and Unsustainable Versions of the “Good Life”

Unlike the increasing flows of money, goods, people and ideas across national borders that constitute the heart of globalization, carbon flows across borders independently of human action. It is a headline issue because all of the above-mentioned global flows have exacerbated climate change, and because solutions involve global agreement on goals and the creation of untried institutional mechanisms. If global warming is to be halted this century, total emissions have to be capped and cut and all states will have to participate in securing that outcome.

However, the fundamental driver of our climate problems is arguably the incipient spread of an unsustainable Western version of the “good life”. Resource-intensive, high-carbon, western lifestyles are frequently criticized

<sup>4</sup>Deregulation has generally preceded “privatization”—though the attempted privatisation of natural monopolies has required a high degree of regulation which the former movement rubbished as ineffective.

as unsustainable and deeply unsatisfying, and yet it would appear that their ethical legitimacy has been established by the adoption of a bowdlerized version of utilitarianism that its most famous exponents would have derided. Jeremy Bentham himself believed in a form of utilitarianism that maximised, but which applied to everyone equally, and which included a very important principle—the principle of diminishing marginal utility [5]. The first loaf of bread makes one happy, the second loaf of bread does not add to one's happiness nearly as much as the first and the third may be positively unhealthy. Of course, it is hard to measure utility directly, so many decide to measure dollars (which until derivatives were easy to count) rather than utility or happiness,<sup>5</sup> ignore the equalizing role of diminishing marginal utility. This arguably leads to a “dollarised” (or “dolorized”!) version of the good life that is not “good” and may not be much of a life. However, whether by good marketing or bad habits, these lifestyles are still attractive to the majority of westerners and to a high proportion of the developing<sup>6</sup> world's middle classes. In so doing, northern profligacy has become southern aspiration. Even if confined to the West such lifestyles are unsustainable: their extension to the rest of the world increases the downward spiral to ecological catastrophe. Since the 1970s, there have been many pleas for western nations to desist from unsustainable aspects of their lifestyle and more ascetic lifestyles have been advocated. While some will choose less energy intensive and environmentally damaging versions of the goods and services they desire, self-denial has rarely been widely popular among those who can indulge themselves, and the numbers pursuing unsustainable lifestyles has increased over the last 30 years rather than decreased. In sum, the key problem is that the West has invented and proselytized an unsustainable version of the “good life” that other countries seek to emulate [2,6].

There can be no solution to climate change until sustainable conceptions of the good life are developed that Westerners want to live and which others might want to adopt. A dialogue between East and West might be very instructive in imagining such conceptions of the good life. Fortunately, many of the things that human beings value most do not require huge investments of energy and an unsustainable use of resources—for example: compan-

ionship, conviviality, conversation. None of Martha Nussbaum's extensive list of human values—to take one prominent example of the emerging broader and deeper approach to these questions—need break the ecological bank [7]. Other alternatives based on maintaining the unsustainable western lifestyles (the evaluative *status quo*), including coercing low-emitting countries to cap their carbon emissions (which is not possible even if it were morally acceptable) and paying those countries to cap their emissions (which is self defeating while unsustainable images of the good life prevail, because one way or another, those being paid to live more sustainable lifestyles will seek the unsustainable “good life”) lack plausibility. A third possibility is that elites in less developed countries will be induced to commit their countries to cap their emissions. While there is a long tradition of such corrupt deals, they should not be contemplated here because they are unsustainable for both parties to such deals.

#### 4. Concerns about Carbon Trading Schemes

While the ultimate solution to climate change is the development of low carbon lifestyles, it is important that economic incentives support and stimulate that search. The sustainable versions of the good life provide an ethical pull. The incentives provide an economic push. The currently favoured approach is to set a cap and then cut total emissions with the trading of emission rights to provide incentives to those who can most efficiently cut their carbon and minimize the cost. This approach is unsurprisingly popular in states emitting the most carbon because it effectively gives them a property right to emit,<sup>7</sup> something that is acknowledged in the literature.<sup>8</sup> However, where an activity is shown to be harmful and unsustainable, it is not immediately obvious that the appropriate response is to create property rights to continue the harmful activity and to give the greatest property rights to those countries or corporations who have done the most harm and have been externalising the costs on others who have suffered and continue to suffer from the harm done. This idea is popular in the West and with those who would profit by the operation of those markets. It is unpopular with non-Western countries which would be given less rights. Indeed, why would they agree? Those who spent the last decade worrying about how to persuade the USA to take part do not seem to have appreciated this obvious objection and seemed to be surprised at the forcefulness of developing countries in the lead-up to Copenhagen.

<sup>7</sup>A new right that appears in no declarations and in no texts—but which is proclaimed by some Westerners.

<sup>8</sup>Issuing permits free of charge (or at low cost) explicitly recognizes the property rights which emitters have had in the past [8].

<sup>5</sup>Demand and supply curves may recognize that the rich man does not value the third loaf of bread but does not recognize that the fact that the poor values the first loaf even more and certainly much more than the rich man's next transient treat.

<sup>6</sup>I use the term “developing” rather than “less developed”, “low income” or “very low income” despite what is sometimes seen as a neo-liberal bias in the term. First, the term predates neo-liberalism. Second, and more importantly, I still maintain the view that we need to develop the economies and politics of the world to allow individuals to take part in the good life through the development of their capabilities and through delivery of material and non-material goods.

Wherever large amounts of assets are found, so will there be attempts to appropriate them. When a very large body of assets is created, the temptation/corruption risk is correspondingly, very large. This point is frequently made about carbon offsets (for example, Daphne Wysham at a plenary session of the 14th IACC). However, the value of the carbon permits is likely to be several times that of offsets. If they are all auctioned, this may be less of a problem. But most proposals suggest giving away most of these valuable assets. If these permits go to the major polluting corporations and companies, it will be the greatest private appropriation of public assets since the Russian privatisations of the early 1990s—except they will be global in scope.

This approach of creating property rights in unsustainable activities also has the perverse effect of encouraging market players to look for the next unsustainable activity in which they can invest to benefit from “grand fathered” rights. It will then be in their interests to maximise the harmful activity to maximise the property rights given when the harm is recognized. This approach rewards polluters, exacerbates pollution and creates perverse incentives for those who know about pollution to invest in it rather than expose it. Faith in such markets may be misplaced in this case, just as it is being sorely tested in the current global economic crisis. The relevant commodity—carbon—is not well understood, and knowledge will thus be asymmetric, allowing market players many opportunities for arbitrage and taking advantage of the ignorance of those who need to access the market to continue their businesses. This process leads to increased costs and risks of doing business (as the market for carbon can fluctuate wildly)<sup>9</sup> so that much of the extra cost of doing business will end up in the hands of market players rather than consumers or producers who have to pay higher prices. There is also the possibility that everybody loses. New markets often get it wrong.

### 5. “Beware of Merchant Banks Bearing Gifts”

The creators and “market makers” for derivatives were very keen to enter into carbon trading. While many are wary of entrusting them with the contents of their piggy banks, it is unlikely that they will be entrusted with the future of the planet: there are many fresh and vivid memories of the way in which new markets are prone to fluctuation and profiteering from asymmetric knowledge.

In promoting volatility, traders benefited at the expense of those who needed to exchange currencies to conduct business through a combination of asymmetric

<sup>9</sup>I recognize that the European carbon market has settled down so that the maximum prices are only about double the minimum prices and that these make it less volatile than many commodity prices. However, there are many artificial aspects of the European carbon market, including the fact that most of the carbon permits required by those who need them are given them for free.

knowledge and outright manipulation. Although some risks could be hedged (generating major profits for the market players), long term risk was uninsurable. By increasing the risk of doing other business, it discouraged what would be an otherwise profitable investment. It is almost universally true that stability is good for industry, volatility is good for traders.<sup>10</sup> Those who will cash in on the volatility are rent seekers, pushing inefficient financial structures that will provide them with profits.

The more enthusiastic merchant bankers are about carbon trading the more we should be wary of it. I can see why believers in the efficient markets hypothesis, strengthened by the success of SO<sub>2</sub> trading schemes might have been enthusiastic for carbon trading schemes in the past. However, the experience of the GFC with complex financial instruments should make us very wary of trying to create a complex market for current and future carbon credits. While CDOs, CDFs and ETFs once looked solid and now look virtual (sometimes in the sense of being non-existent), future carbon credits may seem just so much “hot air”. I tend to think that if the GFC had preceded the Rio Conference, nobody would have suggested carbon trading. Now that we have seen the effects of the GFC, it is strange that it has persisted so long.

### 6. Revisiting Carbon Taxes in a New Form: “Carbon Added Tax”

The clearest alternative approach to carbon trading involves the taxation of unsustainable activity rather than granting rights to it. I would suggest a “carbon added tax” (CAT) to operate like a value added tax (VAT). If a CAT operates like a VAT, carbon taxes will be “passed on up the line” until they are ultimately paid by the consumer of the relevant goods and services. The VAT

<sup>10</sup>My understanding of this is not merely theoretical. I have been a Director of a medium sized family company importing high end white goods into Australia since 1976. During the 1980s the extreme volatility of currency markets rendered obsolete our previous policies for addressing the risks of currency changes. Australia’s then Treasurer showed how little he knew (as opposed to purporting to know) when he said that the speculators would, from then on, speculate against each other. Their prime target was, of course, those who had to engage in currency transactions. The bankers came forward with various expensive hedging products that would protect us from the risks that their own trading created and told me that everyone was taking a position on the market—whether or not they covered or did not cover. My response was indignant. I was not in the business of taking a position; I was in the business of importing white goods. They were imposing risks on that business and then offering insurance against that risk. It was a form of protection racket. Following this event, I decided to actively manage the exchange exposure by opening accounts in DM and USD (the currencies in which we purchased most of our goods) and chose when to switch to Australian dollars and, frequently, to switch USD to DM). In the end, I made quite a bit of money by switching DM debts to USD debts and riding the interest rate differentials until the USD fell from the ridiculous and unsustainable heights it had reached in 1986-1987. The profits from this strategy tided our company over the fall out from the stock market crash of 1987 which I, like many, predicted in substance but not timing.

treatment of imports means that those who keep outside the system of carbon taxes would still face the CAT when the goods are imported into a market within the system.<sup>11</sup> It also means that the burden is on those countries which consume high carbon goods and services rather than those who produce them.<sup>12</sup>

This strategy involves the harnessing of the power of markets—though by using a direct and controlled price signal which inhibits high carbon industries and stimulate low carbon industries and provides clear signals to where future entrepreneurs can make their fortunes. It closes off two other ways in which individuals and corporations can make money—through lobbying (and worse) to get free carbon credits or through leveraging asymmetric knowledge and resources to profit from an immature market.

As indicated above, volatility is good for traders and not for those engaging in long term business decisions. A decision to adopt a carbon tax over a carbon trading scheme provides incentives to channel entrepreneurial talent into the new industries without which we cannot grow our economies in ways that provide a sustainable good life for this planet's peoples. The next group of great entrepreneurs are those who will have new ideas of how sustainably to provide goods and services that consumers want in ways that provide a decent living for those who work in them. This approach will involve new ways of providing old goods and services and new goods and services that meet human needs. A decision to adopt carbon trading makes investment in low carbon industries more risky by reducing the certainty of the price advantage that sustainable goods and services can be provided. In so doing, it increases the required rate of return for the investment to be made.

If imports and exports are dealt within the same way as GST/VAT, it is possible to introduce it in a single country without affecting that country's competitiveness. CAT would be levied on all imports and a CAT credit given for all exports. Accordingly, goods and services produced within Australia would not be at a disadvantage against imports in our own markets or against goods and services in other markets. This approach emphasises that it is the consumption of high carbon products and ser-

vices that is the problem and that the burden should fall on the consumers rather than the producers. This reflects the genuine (but rarely expressed) concern that countries which produce high carbon goods or components are treated as just as much of the problem as those who consume them. Much of the manufacturing, mining and smelting that was once done in the West is now done, for example, in China or Australia. A carbon tax will address both consumption and production but the burden of a carbon tax should be on the ultimate consumers not the producers. This approach does not remove the price incentive from producers as high carbon products will be less competitive in export markets.

I note that it could be argued that price elasticity within countries means that the ultimate consumers will not pay—something that is rarely argued for VAT. However, as each country imposes a tax on the carbon included within imports, it becomes certain that the countries whose populations consume the most carbon intensive goods and services will have to pay. Concerns of the inflationary effects such a tax or the increase in government revenues can be addressed by returning revenue to individuals through cuts in consumption tax (either across the board or targeted to produce more socially equitable outcomes—for example, zero-rating classes of goods typically consumed by lower income groups). A CAT provides both negative and positive price signals as low carbon products actually decline in price (though slowly enough to avoid deflation of low carbon products). In general, the point is that there should be a move from taxing consumption to taxing carbon. The gradual substitution of carbon for standard consumption taxes provides room for huge price signals and incentives for reducing green house and other emissions without affecting inflation. (However, in countries where there is a risk of deflation, the inflationary effects might be particularly valuable to keep the general price level increasing. The proceeds could then be distributed to citizens or residents as a per capita payment).

If CAT rose to replace consumption taxes at current rates (10 - 25 percent are typical leading to revenue from the tax at between 5 - 15 percent of GST), the price signal could be made much greater than the carbon trading schemes contemplated. The government could announce a schedule of carbon tax increases over the next decade with a warning that the rate will be increased until carbon consumption was reduced to sustainable levels. This approach has the virtue of allowing industries to change, providing predictability but a clear message that the government has the determination and a relatively easy means to increase taxes on carbon until emissions targets are met. As carbon taxes became more effective, the CAT take might shrink and VAT could then be gradually

<sup>11</sup>Some might question how the carbon emitted in producing imports is calculated. This is a reasonable question—though the question of measurement is an issue for goods produced locally and for carbon trading systems as well. The answer for carbon taxes is a simple one. The carbon emitted by producing particular classes of goods would be estimated on the basis of traditional practice and it would be open to any importer (or manufacturer) to demonstrate that they emit less carbon than that standard. If the cost of proving the lower carbon emissions is greater than the tax benefits to be gained, then they will run with the estimate.

<sup>12</sup>It is a concern is that countries which produce high carbon goods or components are treated as just as much of the problem as those who consume them.

returned without any effect on inflation or taxation as a share of national income.

The distributional effects of carbon taxes do need to be considered. They are likely to be regressive in developed countries where the poor tend to live away from city centres, their work and public transport. This is certainly the case in Australia where the poorer Australians now live in outer suburbs and are more dependent on motor vehicle transport. This is one reason why it is important that taxes that are cut should be regressive taxes (like GST) rather than progressive taxes such as income tax.

## 7. Institutional Reform

If we are going to secure sustainable low carbon lifestyles, we need more than the ethical pull and the economic push. Each needs to be institutionalized—built into the governance of global, regional, national, sub-regional, corporate and professional institutions. Where we currently see the weakness in each exacerbating the weaknesses in others, we need governance reform in all areas supporting sustainable, low carbon versions of the good life.

Attempts to avoid future Global Financial Crises require institutional reform at several levels:

- Global (for example, strengthening G20, mobilizing the UN and its “unique legitimacy”, Basle accords);
- Regional (for example, ECB);
- National and sub-national (where most banking, competition and financial regulation are managed);
- Professional (existing professions like law and accounting must ensure that their services are not used to defraud and add risk; wannabe professional like banking and finance must recognize that professions involve the application of an area of specialist knowledge to further the interests of the community they claim to serve through achieving clear public goods—indeed, they have to recognize that finance is a service industry that serves rather than seeks to profit at the expense of the rest of the community);
- Corporate (corporations need to remember that the reason why we have not heeded Adam Smith’s warnings about merchants gathering together and instead made incorporation much easier is because they have argued that corporations benefit the communities in which they operate. Corporations and their executives must not only repeat this claim but ensure that it is true—first, as a matter of integrity and second, because of their “licence to operate” along with the privileges of incorporation and limited liability. All concentrations of power can lead to abuse of that power—something that Smith’s American contemporaries recognized in governments and which Smith recognized in corporations).

Similarly, avoiding the impending Global Carbon Crisis requires reform at all those levels:

- Global (the post-Copenhagen process, international treaties on carbon and relevant cash transfers, the utilization of the unique legitimacy of the UN, Global Compact, Principles of Responsible Investment, the Earth Charter—and above all through the promotion of cross-cultural dialogue on sustainable versions of the good life);
- Regional (regional organizations need to collaborate on environmental issues and in assisting each other to cope with climate change and environmental refugees);
- National (through the establishment of carbon taxes—or carbon trading if they must);
- Professional (existing professions such as law, accounting and engineering should seek to build and apply their specialist knowledge bases so that they can assist their clients not only comply with environmental laws but become ethical entrepreneurs, seeking new ways to reduce the carbon emissions associated with their activity);
- Corporate (corporations need to serve their communities and themselves by finding goods and services that support a sustainable good life for their customers, employees and shareholders—applying their entrepreneurship to developing new low carbon, zero carbon and negative carbon industries);
- These reforms will include institutions at various levels that measure carbon emissions for taxing and/or trading and carbon abatements for trading schemes.

The importance of good institutional governance is recognised by many disciplines which might make a contribution to institutional governance and reform. The problem is not that it is ignored: the problem is that each discipline has a strongly theorised but limited conception of institutions, which colours and structures their view of the nature of institutional problems and the best means for addressing them. For example, lawyers look at institutions and see sets of formal norms, ethicists see informal norms and the values the institution claims to further, economists see incentives and disincentives, political scientists see power relations, social psychologists see complex webs of interpersonal and group relationships, and management theorists see structures and systems. Accordingly, the problems are seen in the deficiency of laws, ethical standards, incentives, power relations, systems, and so on, and the solutions are seen as lying in remedying those specific deficiencies.

All these partial insights into institutions and their problems are important and any solution that ignores them is likely to fail. However, as proffered solutions tend to be developed from only one disciplinary perspec-

tive, they are necessarily limited, perhaps over-emphasising legislative solutions or the impact of economic incentives. As indicated above, this was not a problem when Smith and Bentham were writing. However, the explosion of literature within each of the relevant disciplines means that we need strong interdisciplinary teams with mutual understanding and respect for what their disciplines can contribute if we are going to provide insights into how these institutional reforms may be achieved.

## 8. Integrity Systems

It is now widely recognized that improving governance and combating corruption should not be entrusted to any single institution, single law or single methodology. It is now recognized that such goals are best achieved by a variety of institutions (for example, governmental, corporate, professional, NGOs). These institutions will support each other when they are performing their role within the integrity system and check each other if they do not.

I have argued over the past two years that dealing with the GFC and avoiding the GCC similarly require a range of institutional responses at global, regional, national, sub-national, corporate, professional and NGO levels. We should map the current global financial integrity system and global carbon integrity system to identify what institutions are operating, their strengths, weaknesses and the degree to which they are mutually supportive (see my discussion of integrity systems and at the 12th IACC) [1]. We should then examine where those integrity systems can be improved—through adding new institutions, strengthening existing institutions and developing stronger links between them.

## 9. North-South Financial Flows

Because the North has contributed most to the problem, built its wealth on high carbon activities and will continue to do so until we reduce carbon emissions to sustainable levels, it is recognized by most that transfers of resources from the North to the South will be required. This was part of the flawed thinking behind carbon trading and behind the Copenhagen discussions of international climate change finance.

There are genuine concerns that there will be corruption in this process:

- 1) If we adopt carbon trading, bogus carbon credits will be created;
- 2) If we transfer funds to developing countries, will these be siphoned off by elites who exercise disproportionate power (and incidentally tend to use just as much carbon as the elites of developed nations);
- 3) If the west controls the funds, they may be used for

their own purposes. In any case, such transfers are not a matter of charity but of compensation. It is a way of saying thank you for not destroying the planet in the same way as we have been doing, and thank you for not damaging it as much as we will be doing over the next few years.

These problems will need to be addressed by integrity systems as discussed above. However, I would argue that the ultimate answer is that the carbon tax is returned to individuals. If sustainable carbon emissions total, say, two tonnes of carbon per person, then each individual should receive a payment equal to the tax on two tonnes of carbon each year. These refunds should be in payments to individuals rather than governments to ensure that they get through to those who need to benefit. It also reflects the fact that the poorest people in the world are generally in the most corrupt and undemocratic of societies whose governments are least likely to pass on the benefits of any carbon windfall. Ultimately, a more ambitious model might be considered in which a number of taxes become globally collected. These are made up of taxes that are increasingly uncollectible at a national level (for example, company tax and death duties) and those that should be imposed at a global level for systemic reasons (carbon taxes, Tobin tax, taxes on resources taken from the sea outside of national economic zones). These could be collected together and provide a “Global Minimum Income” for all persons on the planet. This approach would follow the logic of “Basic Income” and “Guaranteed Minimum Income” schemes which recognize a right to resources based on citizenship and a duty to pay taxes based on economic activity. The value of the distribution would be limited in the richest countries but would have the potential to be totally transforming in poorer ones. This approach may be some time off, but an approach like this to handling any north-south cash transfers might not only be just but may ultimately be required to secure the genuine consent of the governed in developing countries.

I appreciate that the logic of collective action (and the reasons we have and need governments) is that some things cannot be done by individuals or at least not as effectively. However, where collective action and resources are not deployed for community benefit but by those who have captured the state, it might be better to transfer those funds to individuals. If governments want to deploy those funds for collective goods, they must persuade the citizenry to agree to transfer their money to the government. If governments are not prepared to distribute the funds to individuals, there will be no North-South transfer. While conditionality may be challenged generally and in particular for carbon transfers, this particular form of conditionality is hardly one that will lead

to objections by the citizenry. Indeed, if the government refuses to accept the funds because it will be passed on to the citizens, this decision will add to their unpopularity. If they cannot persuade their citizens to transfer these funds to them, then they probably do not have a better use for it.

There are other emerging global problems in competition for land between growing food, growing biofuels and growing plantation timber for carbon sinks. All this has happened before—in taking over land for cash crops in developing countries in the late nineteenth and much of the twentieth century, and earlier for enclosures. The use of land for more lucrative pursuits is presumably justified if those who would have otherwise secured food from the relevant land get enough of the benefits to buy food from other sources. Yet, sometimes the efficiency is merely gained from producing less value but with less labour—for example, plantation timber versus intensive farming—which may be a benefit to the landowner but not necessarily to society (where total GDP is reduced). We must avoid solutions in which unsustainable western lifestyles are preserved by taking over food growing land that would otherwise feed the world's poor. As indicated above, however, the ultimate answer is that the carbon tax is returned to individuals.

## 10. Financial Globalization and Sustainable Globalization

If globalization involves the flow of people, ideas, goods and money, the last has grown most rapidly—indeed, well in excess of the flow of goods and investment that it is supposed to support. Developing countries have entrusted their enormous and growing surpluses in western banks and other financial intermediaries. Some, such as East Timor, have been pressed by western run multilaterals to entrust the proceeds of extractive industries in Wall Street on the basis that it was less likely to be eroded by corruption. The amounts entrusted to such intermediaries in the US and elsewhere on the basis that they would be invested on a secure and conservative basis were unprecedented. It now appears that entrusted powers over vast sums of money were abused for personal gain. Many within financial intermediaries have played with that money in ways that maximized their fees while increasing the risks to their investors. The ratings practices were scandalous and incredibly insulting to well run businesses and governments whose risk was far less than 110 percent non-recourse mortgages on inflated values to NINJA borrowers (no income, no job, no assets). The fact that their risk models were based on the probabilities of individual defaults and ignored the possibility of an overall decline in property markets is merely more evidence of incompetence, negligence and

“arrogance beyond their means”. Once such ratings could be secured, the signing up of mortgagees, the packaging of those loans, their rating and their sale to local citizens and foreigners looks like a well oiled “corruption system”. Even though they did not see themselves as corrupt, several parties were maximizing their fees while squandering profits at the expense of those who entrusted them with their funds. The unedifying subsequent sharp shift from greed to blind panic only adds to the contempt that so many have engendered.

In reforming the international financial system, a new goal should be affirmed—ensuring that those who are entrusted with investing funds for others do not abuse that entrusted power to increase their wealth at the expense of those for whom they invest. This goal does not mean that banks should not be rescued. The fact that they were poorly run is not the point. If they had been well run, they would not need to be rescued. Rescues are instigated to protect the wider economy, business confidence and depositors who were not accepting suspiciously high rates—while seeking to ensure that the owners and managers of such banks remain as exposed as possible to the consequences of their mistakes. Neither does this mean that all participants acted unethically or illegally. However, if confidence in the international financial system is to be restored in the long term, and if the proceeds of developing country surpluses and western superannuation funds are to continue to be entrusted with intermediaries for investment in the globalized economy—thereby supporting sustainable globalization rather than undermining it, then, this can only happen if there is a full investigation of what went wrong and options for the establishment of adequate financial integrity systems are debated, selected and implemented as part of the Global Integrity System. Such an investigation will have to include members of developing as well as developed countries and be supported by the work of international researchers, NGOs and international organizations. In this process, the Equator Principles, the UN Global Compact, the UN Principles of Responsible Investment will need to be reconsidered and implemented.

## 11. Recognising the Multiple Roles of Individual

While the architecture of sustainable global governance and sustainable globalization is largely institutional, we should never ignore the individual dimension. We should identify our own actions that can further stated good governance values. We must recognize that we can act at three levels: as citizens, as investors, and as consumers. When we act, we have responsibility for the consequences of our actions. The fact that we are acting as consumers and investors does not excuse us from that re-



sponsibility. However, between our actions and the achievement of intended consequences lie a number of institutions: as citizens we rely on political parties, parliaments and bureaucracies to implement our collective choices; as investors, we rely on advisors, trust funds, fund managers and corporations to connect our values with our investments; and, as consumers we rely on manufacturers, service providers, retailers and advertisers to inform our choices and deliver them. We empower these institutions by voting, investing and consuming. We must recognize that those institutions may well abuse that power. Accordingly, we should demand institutional changes to limit the ability of those institutions to abuse the power entrusted to them.

We should recognize that action on one front can affect action on other fronts and campaigns should press for action on all three fronts. We should especially seek to harness the ultimate owners of most corporations—superannuants. The latter have been actively discouraged from thinking of themselves as having any interests or values—effectively, and insultingly, required to be “economic man”. Their interests, however, are long term and not confined to the market return on their investments. They have other economic interests as employees, taxpayers and parents. An action that marginally increases the return on their investments but raises unemployment or requires taxpayer funded clean-ups or bailouts is against their overall economic interests. The best entrepreneurs are those who build sustainable businesses; but a large part of the problem has been that the financial intermediaries who handle superannuants’ money are driven by short term incentives.

Investors also have values that go beyond economic interests. They are not only entitled to seek to further these values through their investments but are responsible for their choices. Shareholders’ values may vary but this merely means that funds should differentiate themselves on the basis of the values they seek to further. As most superannuation funds aim for diverse investments and align shareholdings with stock market indices, superannuants are becoming “universal investors”. Any attempt by businesses to externalize their costs hurts another one of the superannuant’s investments—and often the superannuants themselves. Accordingly, the externalization of costs is not a game that superannuants can afford and neither they, nor the funds who invest their money, should be willing to play. There is a direct line between ethical and socially responsible investment by individuals, funds adopting and implementing the UN Principles of Responsible Investment, and corporate social responsibility initiatives such as the Global Compact [9].

## 12. Concluding Remarks

There will always be a role for markets. Their dynamic

power allows us to trade what we have for what we would prefer. While this power may be harnessed to serve our interests, untrammelled markets will not do so. Adam Smith famously wrote: “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own self-interest” [10]. It might equally be said that it is not the malevolence of the mortgage broker that writes the NINJA loan or the ratings agency that anoints it “AAA”. It is not the malevolence of the arms manufacturer that invents the cluster bomb or the polluter who destroys the planet. It is from their regard for their own self interest. Self interest is an important driver but there are some other critical variables or preconditions that determine whether self interest is channelled to put food on our plantation timber table or cluster bombs in an overheated and flood prone backyard that has been repossessed by a zombie bank.

Capitalism must be made to serve the interests of the communities in which it operates by making it responsive to the real values of the real people who own most of it rather than the values of those who manage our money in ways that maximise fee generating transactions. The year 2009 was the 250th anniversary of the book that Adam Smith regarded as his most important and which provided the essential grounding for the *Wealth of Nations*. *The Theory of Moral Sentiments* [11] is now considered primarily to concern moral philosophy and the latter economics, so that some might say that moral philosophy or ethics is prior to and more important than economics. Yet Smith would not have said that. He and his philosophical contemporaries lived before the separation of disciplines and, like Jeremy Bentham, Smith would have seen little point in separating the modern disciplines of law, ethics, politics and economics whose separate formation post-dated their work and their insights [12,13]. Governance requires their reintegration and their service to those our institutions are supposed to serve—us [1,14,15]. At the same time, we need to think through our values, integrate those values into our own conception of the good life and then integrate our actions as citizens, consumers and investors so that we may, in fact, live sustainable conceptions of the good life.

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